

In the Matter of

WC Docket No. 04-313

CC Docket No. 01-338

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SUMMARY

The comments of other parties confirm that without unbundled local switching (“ULS”), competitive local exchange carriers (“CLECs”) will be impaired in their ability to provide local exchange service to payphone service providers (“PSPs”). To prevent impairment of competition and fulfill the payphone-specific goals of the Communications Act, the Commission must maintain the availability of ULS to CLECs attempting to serve PSPs, even if the Commission does not require ULS to be available in other market segments.

None of the commenting parties disputes that the court of appeals’ unbundled network element (“UNE”) decisions require the Commission to take account of material variations among distinct local service market segments when crafting its UNE rules. The PSP market is a discrete and independent market segment for impairment purposes. As the comments confirm, PSPs clearly do not fit within the enterprise market because the vast majority of payphone locations have three payphone lines or less, easily disqualifying them for service with DS-1 loops. Moreover, PSPs clearly do not fit within the “mass market” as defined by the regional Bell Operating Companies (“RBOCs”). According to the RBOC studies, the “mass market” is characterized by a large and ever-increasing demand for multimedia bundles of voice and data services delivered over broadband networks, and for wireless services that do double duty as fixed and mobile services. Payphones, however, are fixed, voice-only installations. They have virtually no use for internet access or other broadband capabilities and do not need or benefit from mobile service capability. The “mass market” as defined by the RBOCs thus excludes PSPs.

Separate review of the PSP market segment is especially important because Congress, in enacting Section 276, effectively defined payphones as a discrete market. By ensuring that CLECs can compete to provide service to PSPs, the Commission will advance not only the local service competition goals of Section 251, but also the payphone competition and deployment goals of Section 276. Widespread deployment of the unique resource that payphones represent in turn advances both the universal service goals of Section 254 and the bedrock objectives of the Act, by ensuring that there is a universally available back-up communications option when subscription telecommunications services are unaffordable or unavailable or when consumers need immediate access to communications in an emergency or outage.

These goals and policies must be factored into the Commission's impairment analysis. Indeed, in light of the key role played by payphones in the scheme of the Act, the Commission can and should require ULS to be available for competitive local service to PSPs even if the barriers to competition in that market segment did not meet the criteria for statutory "impairment."

In fact, however, CLECs *are* seriously impaired in serving the payphone segment of the market. The data supplied by the RBOCs and other parties confirms that PSPs cannot be economically served by CLECs using UNE-L. The average monthly revenue collected by CLECs from lines serving PSPs is about \$22 -- far below the figures quoted for the mass market. Yet, RBOCs and CLECs both report that mass market CLECs and their customers are migrating en masse *away* from UNE-L. Verizon states that UNE-based competition for the mass market "has been overtaken by the intermodal alternatives." If CLECs and their customers have already concluded that

CLECs cannot economically serve the mass market with UNE-L, then there is no chance of a different outcome for the PSP market.

Even if CLECs could serve business customers in the mass market with UNE-L, it would not be economically feasible to serve PSPs. FCC statistics cited by the RBOCs indicate that the average revenue from mass market business customers is \$46.43 per line per month, more than twice the revenue available from PSPs. Even if one assumes the accuracy of the relatively low RBOC cost estimates submitted in state proceedings, it is clear that CLECs could not justify providing UNE-L service to PSPs. The monthly costs of serving PSP lines would exceed the available revenues by \$4 to \$17. Moreover, these cost estimates presume that UNE-L service providers will gain a substantial share of the mass market. As noted, such assumptions cannot be squared with RBOC projections of highly successful intermodal competition.

RBOC data also confirm that CLECs cannot economically use broadband to serve PSPs, who have virtually no use for internet access or data communications. Even if VoIP could handle PSPs' needs for Flex ANI, reliable E911 access, and protection from power outages, at the quoted prices of \$62 to \$90 per month VoIP equipped broadband connections cannot possibly compete with the barebones POTS service that is all PSPs require.

Similarly, the RBOC data show that commercial mobile radio service ("CMRS") is not a viable option for payphones' local service connections. Even if CMRS were reliable enough and included the features PSPs need, the \$40-60 per month quoted by the RBOCs is far more than the \$22 per month price of UNE-P service.

In summary, the data submitted by the parties conclusively shows that CLECs cannot economically enter the PSP segment of the local service market with either UNE-L or intermodal alternatives. Therefore, the Commission must require UNE-P to remain available to CLECs serving the PSP market.

**Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554**

)	
In the Matter of)	
)	
Unbundled Access to Network)	WC Docket No. 04-313
Elements)	
)	
Review of the Section 251 Unbundling)	
Obligations of Incumbent Local)	CC Docket No. 01-338
Exchange Carriers)	
)	

**REPLY COMMENTS OF
THE AMERICAN PUBLIC COMMUNICATIONS COUNCIL,
DATANET SYSTEMS, LLC,
ERNEST COMMUNICATIONS, INC.,
NAVIGATOR TELECOMMUNICATIONS, LLC,
NII COMMUNICATIONS,
NY TELSAVE, and
SYMTELCO, LLC**

The American Public Communications Council ("APCC"), DataNet Systems, LLC, Ernest Communications, Inc., Navigator Telecommunications, LLC, Nii Communications, NY Telsave, and Symtelco, LLC ("Payphone Commenters") hereby submit reply comments on the Commission's Order and Further Notice of Proposed Rulemaking in this proceeding.¹ APCC is the national trade association of independent payphone service providers ("PSPs") and the other Payphone Commenters are

¹ Order and Notice of Proposed Rulemaking, FCC 04-179 (Aug. 20, 2004) ("*Further Notice*").

competitive local exchange carriers (“CLECs”) who provide local exchange service to PSPs. These reply comments focus on the discrete segment of the local exchange service market in which CLECs are attempting to compete with incumbent local exchange carriers (“ILECs”) and with each other in the provision of local exchange service to PSPs. The payphone segment of the local exchange market must be analyzed separately from the mass market and the enterprise market for purposes of determining impairment.

The comments of other parties confirm that without unbundled local switching (“ULS”) CLECs will be impaired in their ability to provide local exchange service to PSPs. In fact, without the availability of ULS — and thus of UNE-P — independent PSPs will have no realistic competitive alternative to the ILECs, who are the PSPs’ own chief competitors in the provision of payphone service to the public. To prevent impairment of competitive local service to PSPs and to fulfill the payphone-specific goals of Section 276 (47 U.S.C. § 276), the Commission must maintain the availability of unbundled switching to CLECs attempting to serve PSPs. Since the PSP market is a discrete and independent market for impairment purposes, the Commission can – and should – require the unbundling of switching to serve PSPs, even if the Commission decides that it is no longer necessary to make unbundled switching available to CLECs for purposes of serving other segments of the local service market.

I. THE PAYPHONE SEGMENT OF THE LOCAL EXCHANGE SERVICE MARKET IS A DISTINCT MARKET SEGMENT

A. The Commission Must Consider Material Differences Between The PSP Market Segment And Other Local Service Market Segments

None of the commenting parties disputes that the court of appeals' UNE decisions² require the Commission to examine distinct local service market segments when crafting its unbundled network element ("UNE") rules. Otherwise, the Commission cannot recognize when individual market segments "vary decisively" in relation to the criteria for "impairment" in Section 251(d)(2) of the Communications Act. 47 U.S.C. § 251(d)(2); *USTA II* at 570. Indeed, many of the commenting parties on both sides of the issues stress the importance of addressing distinctions among service markets and market segments.³

As the Payphone Commenters showed in their initial comments, the provision of local exchange service to PSPs is a discrete local exchange service market that is materially different from both the enterprise market and the mass market.⁴ Unlike customers in the enterprise market, PSPs typically operate a "route" of dispersed payphone locations, the vast majority of which have only one or two payphones and thus cannot possibly be served by DS-1 lines. Payphone locations also differ from the mass market in that switch-based CLECs generally incur more costs and can expect far lower revenues from serving PSPs than from serving mass market customers.

² *USTA v. FCC*, 290 F.3d 415 (D.C. Cir. 2002)("*USTA I*"), *cert. denied*, 538 U.S. 940 (2003); *USTA v. FCC*, 359 F.3d 554 (D.C. Cir. 2004)("*USTA II*").

³ *See, e.g.*, Comments of Verizon at 27-28 ("Verizon Comments"); Comments of the PACE Coalition *et al.* at 4 ("PACE Comments").

⁴ Comments of APCC *et al.* at 14-15 ("PC Comments").

Moreover, in enacting Section 276 Congress has effectively defined the market for local service to PSPs as a discrete segment. 47 U.S.C. § 276. In determining what UNEs should be available to CLECs attempting to serve the PSP segment of the local exchange market, the Commission must give weight to the goals of Section 276, which directs the Commission to “promote payphone competition and the widespread deployment of payphone services to the benefit of the general public.” 47 U.S.C. § 276(b)(1). By ensuring that CLECs have an opportunity to compete to provide local service to PSPs, the Commission will not only advance the local service competition goals of Section 251 but will also promote the payphone competition and deployment goals of Section 276. PC Comments at 7-14.

Widespread payphone deployment in turn uniquely promotes the bedrock goals of the Communications Act, because payphones are a critical means of ensuring that communications are available to all people everywhere, particularly in local and national emergencies. *See* 47 U.S.C. § 151 (purposes of the Communications Act are universal communications service, national defense, and public safety).

Payphones likewise advance the Act’s more specific universal service objectives. *See* 47 U.S.C. § 254. As the Commission recognized in its recent order revising the per call dial around rate of payphone compensation, payphones are a unique communications resource:

[P]ayphones are accessible on demand to consumers without initial investment or monthly charges, and provide a unique back-up communications option when subscription services – whether wireline or wireless – are unaffordable or unavailable. Payphone services are particularly critical to those with few other communications service options – including low-income customers, the elderly, and residents

of rural areas. Payphones also enhance access to emergency (public health and safety) services.⁵

All these factors and policies dictate that the Commission must treat payphones as a discrete sector of the local services market. In its impairment analysis, the Commission must address the material distinctions between the PSP market segment and the “mass” and “enterprise” markets (and any other relevant market segments). PC Comments at 16.

Indeed, payphones advance so many important goals of the Communications Act that the Commission could and should make ULS available for competitive local service to PSPs even if the barriers to such competition did not meet the criteria for statutory “impairment.” *Id.* As pointed out by the PACE Coalition, the Commission has previously recognized that the “at a minimum” standard of Section 251(d)(2) would support an unbundling requirement to advance important objectives of the Act even in the absence of a formal finding of impairment. PACE Coalition Comments at 2. In the Triennial Review Order,⁶ the Commission specifically “reject[ed] arguments that the Commission can only use the ‘at a minimum’ language to decline to unbundle despite impairment” *Id.*, ¶ 174. Rather, the Commission found that the “at a minimum” language permits it “to make unbundling determinations in light of the Act’s many and

⁵ *Request to Update Default Compensation Rate for Dial-Around Calls from Payphones*, Report and Order, WC Docket No. 03-225, FCC 04-182 ¶ 20 (rel. Aug. 12, 2004)(footnotes omitted) (“*Dial-Around Compensation Rate Order*”); see also *Pay Telephone Reclassification and Compensation Provisions of the Telecommunications Act of 1996*, Third Report and Order and Order on Reconsideration, 14 FCC Rcd 2545, 2550-51, ¶ 10 (1999). (*Third Payphone Order*”).

⁶ *Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, Report and Order and Order on Remand and Further Notice of Proposed Rulemaking, 18 FCC Rcd 16978 (2003) (“*TRO*”).

conflicting goals, not just goals that would limit incumbent LECs' unbundling obligations."⁷

The role of payphones in meeting so many statutory policies and the specific pro-payphone policy of Section 276 also bear directly on the Commission's impairment analysis. In determining whether CLECs are impaired in providing local exchange services to PSPs, the Commission must weigh into the analysis the role of payphones in serving these important statutory goals. *Cf. USTA II*, 359 F.3d at 572 (noting that the Commission could take account of other statutory goals by "craft[ing] a standard of impairment that buil[ds] in" consideration of other goals). In light of these goals, the Commission may find impairment of CLECs' ability to serve PSPs based on a showing that might not suffice with respect to other market segments. At a minimum, the Commission must resolve any uncertainties in favor of finding CLECs impaired in providing local exchange service to PSPs. PC Comments at 16.⁸

⁷ *Id.*; see also *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Third Report and Order and Fourth Further Notice of Proposed Rulemaking, 15 FCC Rcd 3696, 3745 ¶ 101 (1999) ("UNE Remand Order"). Verizon incorrectly interprets the *USTA II* decision when it contends that the *USTA II* court "expressly rejected CLECs' claims that the Commission can 'order unbundling even in the absence of an impairment finding if it finds concrete benefits to unbundling that cannot otherwise be achieved.'" Verizon Comments at 8, *quoting USTA II*, 359 F.3d at 579. The court did *not* preclude the Commission from ordering unbundling in the absence of impairment. The court did not rule on the matter at all, because it did not need to in order to resolve the issues raised by the CLECs. As noted, in the order under review the Commission expressly found that it *could* order unbundling in the absence of impairment. The Commission did not, however, find that circumstances warranting such an outcome were present in the record at the time. *TRO*, ¶173.

⁸ Moreover, the impairment and policy factors that support making ULS available for local service to PSPs need not be balanced against any concerns about discouraging investment in broadband infrastructure. See 47 U.S.C. § 706; *USTA II*, 359 F.3d at 578-85 (upholding the Commission's consideration of Section 706 goals in declining to require unbundling of broadband loops). As discussed below, payphones cannot be effectively served by broadband; therefore, preserving CLECs' ability to serve PSPs with ULS will not have any effect on broadband investment incentives.

In any event, for the reasons stated in the Payphone Commenters' initial comments and in Section II below, CLECs *are* impaired in serving the payphone segment of the market without ULS. The regional Bell Operating Companies' ("RBOCs") attempts to show that there is no impairment vis-à-vis the "enterprise market" and the "mass market" do not contradict this showing, because those markets, as defined by the RBOCs, do not include the payphone segment of the local service market.

B. The Enterprise Market Does Not Include The Payphone Segment Of The Local Service Market

The comments confirm that PSPs do not fall within the enterprise market, defined as users of DS1 (1.544 Mps) or higher-capacity loops. *TRO* ¶ 197 n. 624; *see also* BellSouth, SBC, Qwest, and Verizon, UNE Fact Report 2004 at III-1 (filed October 4, 2004) ("RBOC UNE Fact Report"). The PACE Coalition, for example, presents a convincing case that DS1 lines typically are economical only for customers with more than twelve lines at a single location. PACE Comments at 59-63. The vast majority of payphones, by contrast, are at locations with far fewer payphones. APCC requested information from its five largest member PSPs, who operate a total of 115,000 payphones at diverse types of locations in virtually every state, regarding the number of lines served at their locations. One of these PSPs reported that the average number of payphones at its locations was 1.65 phones per location. Another reported that, out of more than 11,000 locations, 75% had only one payphone, 18.5% had two payphones, 3.8% had three payphones, and only 2.5% had more than three payphones. These reports, which are consistent with the Commission's findings in the payphone

compensation rate proceeding,⁹ confirm that the vast majority of payphones are at locations with three lines or less, far less than the PACE Coalition's recommended enterprise market cutoff, and within the cutoff adopted by the Commission in the *UNE Remand Order*. *UNE Remand Order* ¶ 291; *see also* *TRO* ¶ 497.

C. The "Mass Market" As Defined By The RBOCs Does Not Include The Payphone Segment Of The Market

PSPs also do not fall within the "mass market" as defined by the RBOCs. This "mass market" is characterized by a large and ever-increasing demand for multimedia bundles of voice and data services that can be delivered over broadband connections like cable television networks, DSL, and even wireless service. *See* RBOC UNE Fact Report at I-2-6. As the Payphone Commenters explained in their initial comments, however, the market for local service to PSPs is a voice-only market. Payphones do not require or benefit from internet access or other broadband capabilities – they require only a plain-old-telephone-service ("POTS") link to the network.¹⁰

The RBOCs also contend that in the "mass market," there is increasing demand for wireless service that can do double duty as both a mobile and a fixed residential telephone service. Therefore, the RBOCs contend, commercial mobile radio service ("CMRS") providers are unimpaired in serving this market. PSPs, however, do not need or benefit from "mobile" service at all – payphones are installed at fixed locations

⁹ *Dial-Around Compensation Rate Order* ¶ 21 n.66 (more than three quarters of independent payphones are the only payphones at their locations).

¹⁰ PC Comments at 15, 19. PSPs have deployed a handful of public internet terminals in selected locations; however, there is no reason to believe that internet terminals can be economically deployed in more than a small fraction of payphone locations.

and do not move. In this respect as well, the market for local service to PSPs is quite different from the RBOCs' model of the "mass market."

Because the RBOCs have defined the "mass market" in a way that excludes the payphone segment of the local service market, the Commission cannot rely on the RBOCs' comments as a basis for terminating PSPs' access to their only real local service alternative. To the contrary, as explained below, the RBOCs' data submissions effectively confirm that PSPs cannot be served by any of the facilities-based local service alternatives that the RBOCs claim have removed the need for unbundled switching.¹¹

II. THE DATA PROVIDED BY COMMENTING PARTIES CONFIRM THAT COMPETITORS' ABILITY TO PROVIDE LOCAL SERVICE TO PSPs IS IMPAIRED WITHOUT UNBUNDLED SWITCHING

At its core, the Commission's impairment analysis asks "whether all potential revenues from entering a market exceed the costs of entry," with the effect that "entry into a market [is] uneconomic." *TRO* ¶ 84.

The information supplied by the RBOCs and other commenting parties confirms that CLECs cannot economically enter the PSP segment of the local exchange service market using any of the alternatives that allegedly permit CLECs to provide facilities-based service to the mass market. Therefore, CLECs are impaired in their ability to serve the payphone segment of the market unless they have access to unbundled switching.

¹¹ The PACE Coalition and others persuasively argue that there is a large segment of the market, encompassing far more customers than PSPs, that has little or no demand for broadband or mobile services and that lacks viable competitive alternatives without ULS. PACE Comments at 6-8, 11-22, 39-54. Even if the Commission finds that facilities-based CLECs can economically serve the other customers making up this "POTS" market segment, for the reasons stated below it is clear that facilities-based CLECs cannot economically serve the payphone segment of the market.

A. CLECs Cannot Economically Enter The Payphone Segment Of The Market With UNE-L

In their initial comments, the Payphone Commenters showed that switch-based CLECs using UNE-L cannot economically enter the segment of the local service market represented by PSPs. First, switch-based CLECs have not been successful in entering the PSP market segment on a sustained basis. They currently serve a very small percentage of payphones, they are willing to serve only limited areas, and they are reducing the amount of service they are providing to PSPs. PC Comments at 17-18.

Second, the revenues that are available from serving PSPs are insufficient to recover the costs of serving a typical mass-market customer with UNE-L—let alone the added costs resulting from the special needs of PSPs. There are no significant opportunities to sell vertical services to PSPs, and even basic service revenue opportunities are limited, with CLECs' per-line revenues from PSPs averaging around \$22 per month.¹²

The information submitted by other parties demonstrates even more conclusively that UNE is not a viable vehicle for serving the PSP segment of the market with UNE-L.

¹² In their initial comments, the Payphone Commenters estimated that average revenues ranged from \$20 to \$25 per line per month. PC Comments at 28-29. The more precise \$22 estimate reflects further analysis of additional data collected since the filing of initial comments. In response to APCC's information request, three CLECs who use UNE-P to serve more than 100,000 payphone lines in some 20 states reported average monthly revenue of \$22.44 per line. In addition, a group of three PSPs who subscribe to more than 25,000 UNE-P lines in ten states reported an even lower amount as their average monthly bill – \$18.16 per line per month. To be conservative, the Payphone Commenters employ the higher estimate in their calculations of average revenues in the PSP market segment.

1. RBOCs and CLECs agree that mass market CLECs and customers are migrating away from UNE-L

Market trends reported by parties on both sides provide compelling evidence that CLECs cannot economically serve the PSP market segment with UNE-L. Verizon, for example, reports that CLECs are generally abandoning the attempt to serve the mass market using UNE-L. As Verizon puts it:

The reality . . . is that this form of competition has been overtaken by the intermodal alternatives . . . , which are more economical and also provide competing carriers more ability to differentiate their service offerings from the incumbent's.¹³

As a result, as mass-market CLECs and their customers migrate away from UNE-P, they are migrating to intermodal alternatives, *not* UNE-L:

[C]ompeting carriers have already announced that they no longer wish to migrate UNE-P lines to their own circuit switches, and instead plan to compete for mass-market customers using new modes of entry such as VoIP.

Verizon Comments at 111. In fact, Verizon contends that there will be so little movement to UNE-L in the mass market that “the demand for hot cuts will almost certainly be extremely low.” *Id.*

The PACE Coalition agrees – although it contends that there was *never* significant UNE-L competition for the mass market. PACE Comments at 39-54. According to the PACE Coalition:

[M]ass market local competition based on competitively provided switching is insignificant and declining, and there is no reason to expect that it will expand in the future.

Id. at 68 (emphasis added).

¹³ Verizon Comments at 103; *see also* Comments of Qwest Communications International, Inc., at 38 (quoting reports that VoIP and broadband are supplanting conventional circuit-switched service).

This mass market migration trend alone should suffice to conclude the issue of whether CLECs require ULS to serve PSPs. If CLECs and their customers have found that they cannot economically serve the mass market using UNE-L, then there is no basis to expect a different outcome for the PSP segment of the local service market, where costs are even higher and revenues lower than those reported for the mass market.

2. The data confirm that the costs of serving the payphone segment of the local service market with UNE-L far exceed the available revenues

Despite the migration of mass-market CLECs away from UNEs, some RBOCs continue to argue that UNE-L remains a viable vehicle for entry into that market.¹⁴ But even if CLECs could economically enter some segments of the mass market with UNE-L, the data submitted by the RBOCs and others confirm the Payphone Commenters position that UNE-L CLECs cannot economically offer local service to PSPs. Even under favorable conditions, the estimated costs of using UNE-L to serve the payphone segment of the local service market far exceed the available revenues.

The RBOCs' data and analysis confirm that the \$22 average monthly revenues per line available from PSP customers are far from adequate to recover the costs incurred by CLECs in serving a PSP customer with UNE-L. According to the RBOCs' data submission, "the vast majority" of the "3 million mass-market lines" that were allegedly served by switch-based CLECs using UNE-L at the time of the *TRO*¹⁵ "were

¹⁴ See, e.g., Comments of SBC Communications International, Inc., at 39-49.

¹⁵ As discussed in the PACE Comments at 39-54, evidence in state proceedings casts doubt on whether current mass-market use of UNE-L comes anywhere near this level.

being provided to small business customers” rather than residential customers. RBOC UNE Fact Report at II-41, 42. The “principal explanation” for this, according to the RBOCs, is that “the revenue opportunities of serving business customers are greater.” The FCC’s study of rates determined that the average local rate for single-line businesses is \$46.43. See Ind. Anal. & Tech. Div., WCB, FCC, *Reference Book of Rates, Price Indices, and Household Expenditures for Telephone Service* (2004) at Tables 1.2 and 1.8, cited in RBOC UNE Fact Report at II-42.

If CLECs using UNE-L generally require mass market customers to produce average revenues of \$46.43 per line per month,¹⁶ it is patently obvious that CLECs will not be able to serve the PSP market, where the average revenues are half as much. While a CLEC might have some chance of recovering the costs associated with serving a typical mass market business customer, it has no chance of recovering its costs of serving a PSP.

The following table demonstrates that CLECs are impaired in serving the PSP market with UNE-L. The table compares the average net margin (revenues minus costs) that CLECs could expect when using UNE-L to serve a PSP customer with their average net margin in serving a mass market customer. The revenue figures in the Table are those already discussed – the \$46.43 reported average monthly revenue from a mass market business line and the CLECs’ \$22.44 average monthly revenue from a PSP line.

¹⁶ Moreover, this average rate presumably does not include charges for internet access, another source of revenue for UNE-L-based CLECs, for which there is substantial demand among small businesses and virtually no demand among PSPs.

The cost figures presented in the Table are taken from two analyses in the *TRO* record—one prepared by BellSouth¹⁷ and one prepared by SBC¹⁸—that purported to demonstrate that CLECs are not impaired in serving the typical mass market customer, at least in some cases.¹⁹ Accepting these cost figures – which some commenters have argued are too low – without conceding their validity, it is apparent that the costs of providing service with UNE-L exceed the total revenues available from a PSP customer.²⁰

¹⁷ See BellSouth Corporation, “CLECs Not Impacted in Using UNE Loops to Compete,” enclosed with Letter to Marlene H. Dortch from Glenn T. Reynolds, Vice President-Federal Regulatory, BellSouth, in WC Docket No. 01-388 (January 30, 2003) (“BellSouth Impairment Analysis”) (attached to these Reply Comments as Attachment 1).

¹⁸ See Letter to Chairman Michael Powell from James C. Smith, Senior Vice President, SBC Telecommunications, Inc., CC Docket No. 01-388 (January 14, 2003) and enclosed documents (“SBC Impairment Analysis”) (excerpts attached to these Reply Comments as Attachment 2).

¹⁹ In both cases, the cost figure is the total monthly cost of serving the customer, including SG&A and operating expenses. See BellSouth Impairment Analysis at 2, 7; SBC Impairment Analysis, Att. 3 at 2-7. Both BellSouth and SBC subtracted their respective cost figures from what they contended were typical revenue figures for a mass market customer to demonstrate that a switch-based CLEC serving such customers would have a positive net margin. Here that same analysis results in a negative net margin.

²⁰ Use of the SBC and BellSouth mass market cost figures is conservative not only because they have been criticized as too low but also because, as the Payphone Commenters demonstrated in their initial comments, CLECs incur greater costs in serving the PSP market because of the need to, among other things, add Flex ANI functionality to their switches. Thus, while the Table 1 comparison assumes that the per-line cost of serving a PSP is the same as for a mass market customer, those costs are actually higher, resulting in even greater impairment.

Table 1 CLEC Net Margins

		Revenue	
Cost		PSP	Mass Market
Cost	BellSouth	\$22.44	\$46.43
		\$26.69 ²¹	-\$4.25
			\$19.74
	SBC	\$39.63 ²²	-\$17.19
			\$6.80

This RBOC analysis confirms the Payphone Commenters' position that CLECs cannot economically enter the payphone market segment with UNE-L. While it might be economical for a CLEC to use UNE-L to enter a mass-market segment where the average monthly revenue is \$46.43, it cannot possibly be economical for a CLEC to use

²¹ The \$26.69 cost figure is taken from Scenario 2 in BellSouth's analysis. BellSouth Impairment Analysis at 7, 8. BellSouth provided a range of cost estimates based on the number of access lines at a given central office ("CO"). The \$26.69 cost figure, which assumes a CO with more than 25,000 access lines, is the lowest cost figure provided by BellSouth. The highest BellSouth figure, based on a CO with less than 5,000 access lines, was \$51.93. The BellSouth cost figures are based on underlying switching cost figures provided by MCI, which assumed a 5% market share. BellSouth adjusted (i.e. lowered) MCI's switching cost figures by calculating what BellSouth asserts to be more reasonable collocation costs, which were one of the inputs into MCI's figure. BellSouth then added its own actual average UNE-L charge and an SG&A figure taken from the FCC's Synthesis Model to arrive at a net cost per line. *Id.*

²² The \$39.63 cost figure is taken from SBC's analysis. SBC calculated the total cost of serving a mass market customer, including SG&A and operating expenses, in the three states with the then-greatest UNE-P penetration: California, Michigan, and Texas. SBC Impairment Analysis, Table A. The \$39.63 figure represents the unweighted average of SBC's cost figures (California, \$41.35; Michigan, \$35.52; Texas, \$42.03). SBC's analysis examined a central office with more than 5,000 access lines at both 5% and 10% market penetration levels. *Id.* The \$39.63 is based on the 10% market share calculations. Using the 5% market penetration calculations (as BellSouth did), would result in higher costs.

UNE-L to enter a mass-market segment where the average monthly revenue is \$22.44. Further, as the Payphone Commenters have shown, the costs of serving a PSP are significantly higher than the costs of serving a typical mass-market customer. Therefore, just as it has not been and will not be economical for CLECs to use UNE-L to serve residential customers, it has not been and will not be economical for CLECs to use UNE-L to serve PSPs.

3. The RBOC comments confirm that CLECs' ability to use UNE-L to serve PSPs is becoming even more impaired

The RBOCs' comments also demonstrate that conditions are becoming even less favorable for CLECs to provide local service to PSPs with UNE-L. The migration of mass-market CLECs and their customers to intermodal alternatives will have a major impact on the economics of using UNE-L to serve the mass market. Successful UNE-L-based entry into the mass market indisputably requires large-scale deployment of switching facilities and large-scale commitments to collocation sites as well as relatively high rates of market penetration. The analyses described above assume broad mass market penetration by CLECs using UNE-L. *See, e.g.,* notes 20-21 above. If that assumption proves invalid, then the disparity between costs and revenues becomes much greater.

As noted in Section II.A.1, the assumption of broad mass-market penetration *is* invalid. If the bulk of the mass market – including the high-revenue customers who demand bundles of voice and data services – is migrating to intermodal alternatives, and will not be served by UNE-L-based carriers' switches and collocation sites, the ability of those carriers to justify wide deployment of switches and collocation sites is highly dubious, to say the least. Except in those areas where they have large enterprise customers, UNE-L-based carriers will have even fewer prospects of filling the capacity

of their collocation sites sufficiently to keep the costs of providing service to PSPs close to previously estimated levels – which already greatly exceed the revenues to be expected from serving PSPs.

In short, PSPs cannot possibly be served by UNE-L-based CLECs even in the unlikely event that those CLECs could establish a foothold in the mass market.

B. CLECs Cannot Economically Provide Service To PSPs With Intermodal Alternatives

According to the RBOCs, “the main sources of facilities-based competition for mass-market customers are packet-switched broadband connections and mobile wireless networks.” RBOC UNE Fact Report at II-37; *see also* Verizon Comments at 103. As explained in Section I.C above, however, the “mass market” that demands the multimedia, multipurpose services available from these intermodal facilities has little in common with the PSP market segment, which almost always requires only fixed voice service.

Furthermore, as shown below, the RBOCs’ own data submissions confirm that CLECs cannot economically serve PSPs’ fixed, voice-only service needs using broadband or wireless facilities. Revenues to be gained from service to PSPs fall far below the amounts necessary for broadband and wireless service providers to recover their costs of adding customers.

1. CLECs cannot economically enter the payphone segment of the market using broadband

The comments confirm that the barriers to the use of broadband alternatives are even higher in the payphone segment of the local services market than in the residential and small business market segments. As noted in Section I.C. above, neither cable systems nor other broadband facilities are currently used to provide local service to

PSPs, and only a tiny percentage of payphone locations could possibly have a use for broadband connections. Accordingly, the RBOCs' claim that competitors can provide local telephone service very inexpensively by adding VoIP to existing broadband service has no relevance to the payphone segment of the market.²³

Further, additional data provided by RBOCs and other parties confirm that there is no way for competitors to serve payphones economically at present using broadband-based technologies. Specifically, the RBOCs attempt to show that VoIP will enable CLECs to serve even those customers that do not already subscribe to broadband service. According to the RBOCs, "[a] broadband connection equipped with VoIP service now sells for between \$62 and \$90 per month" including broadband internet access, unlimited long distance service and vertical features. *Id.* at II-19. They contend that these prices are competitive with those for narrowband service packages that include ILEC-provided local service, long distance service, and dial-up internet access. *Id.* at II-18, 19, Table 5. Even if one accepts the RBOCs' price estimates as valid, however, such prices are highly *uncompetitive* with the \$22 per month that the average PSP pays to UNE-P service providers for voice service, the only local service they need.²⁴ Obviously, a broadband service provider could not make a profit selling broadband-based VoIP to PSPs for \$22 per month.²⁵

²³ The RBOCs, for example, submit data to show that "the incremental cost to add VoIP for a customer *that already has a broadband connection* is on the order of \$5-\$9 per month." RBOC UNE Fact Report at II-15 (emphasis added). While this fact may be relevant to CLECs' ability to serve the 25% of U.S. households that allegedly subscribe to broadband service, it does *not* increase CLECs' ability to serve payphones, because payphones do *not* subscribe to broadband service.

²⁴ It is also unclear whether VoIP service providers can economically provide (1) Flex ANI and other features required by PSPs (PC Comments at 24-27), (2) E911 access to emergency services (PACE Comments at 16-17), and (3) service maintenance during power outages (*id.*), all of which are crucial importance to PSPs. If they cannot, any

2. CLECs cannot economically enter the payphone segment of the market using CMRS

The RBOCs argue that the “mass market” for local exchange service is able to be served by means of wireless facilities, because increasing numbers of wireless subscribers are “disconnecting their wireline service” – having their wireless phones perform double duty as both a mobile and a fixed residential phone. *Id.* at II-29. The demand for wireless as a substitute for wireline exists and will continue to grow, according to the RBOCs, because wireless prices have dropped to the point where consumers are willing to trade the greater wireline reliability for the greater value represented by the use of wireless as a fixed service alternative. *Id.* at II-31, 33.

As noted in Section I.C. above, PSPs are not part of the market that the RBOCs claim would benefit from wireless service. PSPs do not need “mobile” service at all – payphones are installed at fixed locations and do not move. Therefore, the price advantages that come from combining mobile and fixed communications needs in a single wireless service do not matter to the payphone segment of the market.

(Footnote continued)

consideration of whether VoIP could be competitively priced for payphones is academic.

²⁵ Factoring in the unlimited long distance offered by broadband VoIP providers does not materially change the result, because PSPs use relatively little long distance service. Most long distance calls made from payphones are “dial-around” calls. *Third Payphone Order*, 14 FCC Rcd at 2614 ¶ 151 (citing RBOC estimates that the average payphone has 280 local coin calls, 155 dial-around calls, and only 43 “other” calls (including operator assisted, directory assistance, and long distance coin calls). Long distance charges for PSPs generally do not reach or exceed the \$10 per month that the FCC estimates as the average household’s long distance service bill. RBOC UNE Fact Report at II-18. *See Third Payphone Order* at 2614 ¶ 151 (estimating that payphones produce about 14 long distance coin calls per month); *Dial-Around Compensation Rate Order* ¶ 26 (noting a major decline in the number of calls per payphone since the *Third Payphone Order*).

As for the possibility that wireless could be priced competitively for purposes of providing fixed local service to PSPs, it is not happening today. PC Comments at 19. Nor is it likely to happen. The RBOCs estimate that wireless service is currently priced at \$40-\$60 per month for local and long distance, including 500 anytime minutes. *Id.* at II-32, Table 9. Although perhaps less expensive than broadband service, these prices are still far more than the \$22 per month that CLECs using UNE-P currently charge for wireline service to the average PSP.²⁶ Moreover, the call volume at an average payphone easily exceeds the 500-minute maximum in the plans cited by the RBOCs.

Further, the RBOCs' wireless price estimates do not include the cost of modifying payphones for wireless transmission, or any charges for Flex ANI and other blocking and screening services – assuming these services are even available from CMRS providers.

Finally, even if wireless was priced competitively for the payphone segment of the market, it is not reliable enough to be used to connect payphones. As a business and commercial matter, PSPs need very reliable, high-quality network connections. There is no reason to believe they are willing to trade quality and reliability for price as other consumers allegedly are.²⁷ As the Commission has recognized, public payphones function as the communications resource of last resort – wireless subscribers, for example, turn to payphones when their wireless phones fail. *Dial-Around Compensation*

²⁶ Factoring in the unlimited long distance offered by CMRS providers does not materially change the result, for the reasons explained in the immediately preceding note.

²⁷ As SBC's Chairman has observed, wireless is "not going to displace the wire-line network Reliability is one big reason." *A Wireless World*, Business Week at 111 (Oct. 27, 2003) (attached to PACE Comments as Exh. 2). See generally PACE Comments at 12-14.

Rate Order, ¶ 20. If payphones were no more reliable than wireless phones, they could no longer be relied upon in emergencies or as the backup for wireless phones, eliminating one of their chief benefits.

* * *

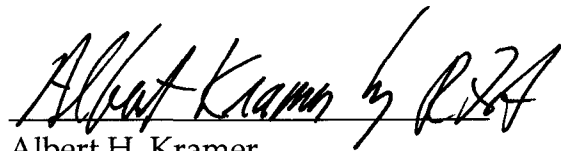
In summary, the data submitted by the commenting parties, including the RBOCs, convincingly shows that CLECs cannot economically enter the PSP segment of the local service market with either UNE-L or intermodal alternatives. Accordingly, the Commission must find that CLECs are impaired in serving PSPs without access to unbundled local switching.

CONCLUSION

Regardless of the outcome of the Commission's impairment inquiry for other market segments, the Commission should find that, without access to unbundled local switching, CLECs are impaired in their ability to serve the distinct payphone segment of the local exchange market. Even if the Commission *cannot* conclusively determine that there is impairment in the PSP market segment, the Commission must still require that, to advance the goals of Section 276, ILECs must make unbundled switching available to CLECs for use in providing local exchange service to PSPs.

Dated: October 19, 2004

Respectfully submitted,



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Attorneys for the Payphone Commenters

ATTACHMENT 1

BellSouth Impairment Analysis

BELLSOUTH

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Vice President -
Federal Regulatory

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January 30, 2003

EX PARTE

Ms. Marlene H. Dortch
Secretary
Federal Communications Commission
The Portals
445 12th St. SW
Washington, D.C. 20554

Re: WC Docket 01-338

Dear Ms. Dortch:

On January 29, 2003, BellSouth met with William Maher, Jeffery Carlisle and Scott Bergmann of the Wireline Competition Bureau in reference to the proceeding identified above. Attending this meeting on behalf of BellSouth were Pete Martin, Lisa Brooks, Bob Blau, Jon Banks and Glenn Reynolds. The attached presentation was discussed during this meeting. In addition, BellSouth urged the staff not to modify the existing use restrictions in a manner that would result in detrimental impact to the existing competitive market for special access.

In accordance with Commission rules, I am filing copies of this notice and attachment and request that they be included in the record of the proceeding identified above.

Sincerely,



Glenn T. Reynolds

cc: William Maher
Jeffery Carlisle
Scott Bergman
Michelle Carey
Tom Navin
Jeremy Miller

**CLECs NOT IMPAIRED IN
USING UNE LOOPS TO
COMPETE**

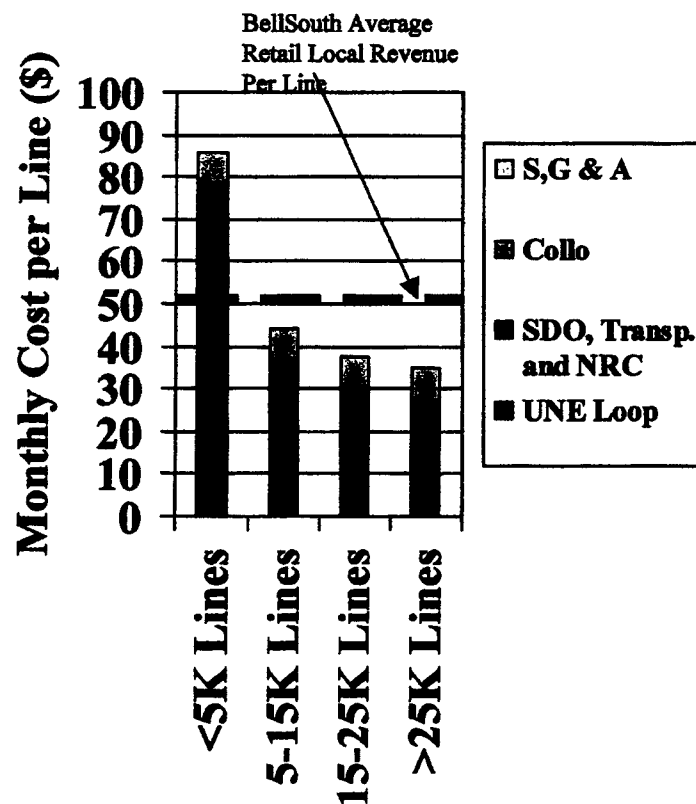
BellSouth Corporation

January 29, 2003

KEY POINTS ON SWITCHING

1. CLECs can economically provide local service without unbundled switching.
 - Comparison of CLEC cost to TELRIC cost is the wrong test
 - CLEC cost more properly compared to revenue potential
 - WCOM's residential only focus is economically irrational
2. The record shows there is a lack of impairment on switching in all areas – CLECs use their own switches to serve customers in urban and rural areas.
3. However, it is a closer call in the rural areas/smaller wire centers.
 - CLECs are clearly not impaired without access to unbundled switching in wire centers with > 5,000 lines
 - 65% of the wire centers in the non-metro areas served by BellSouth have fewer than 5,000 lines
4. BellSouth's analysis using WCOM's cost model corroborates SBC's bottoms-up analysis

WorldCom's Cost Model Shows That CLECs Are Not Impaired In Serving Wire Centers with > 5,000 Lines

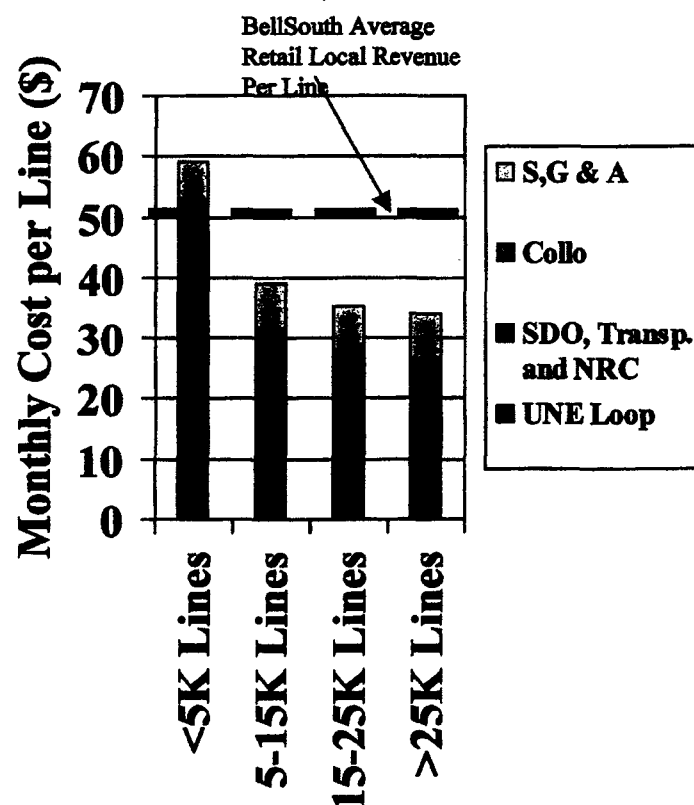


BellSouth's Scenario 1

- WorldCom's 1/08/03 ex parte used as the source for Collocation and "Switching, Digitizing and OSS" (SDO), Transport and Nonrecurring costs
- S,G&A cost taken from FCC Synthesis Model
- UNE Loop rate represents average rate for BST region
- Assumed an average of \$50 average retail local revenue per line (which correlates with BellSouth actual revenues per line)

Key Point: Without UNE-P, CLECs can profitably serve wire centers with greater than 5000 lines based on WorldCom's own analysis

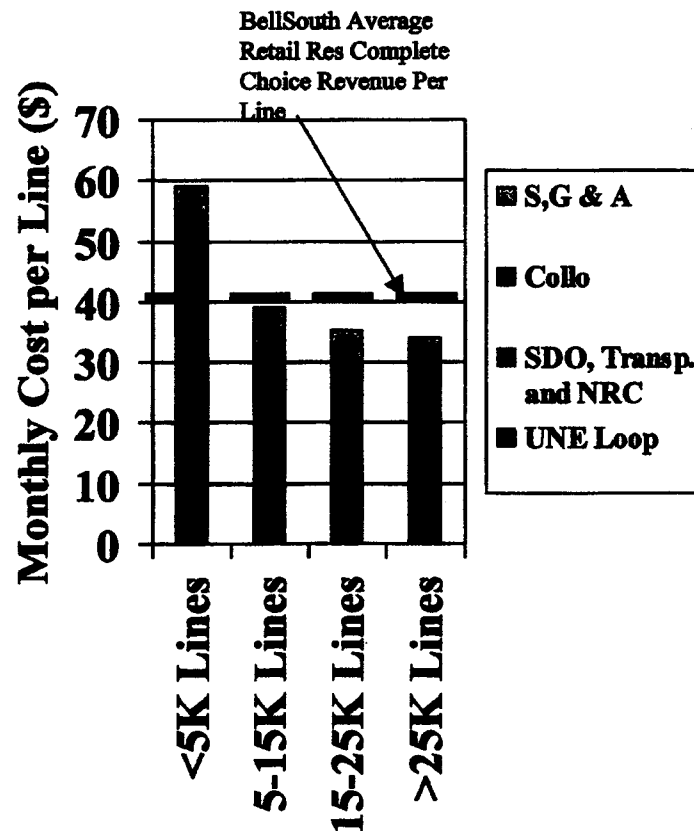
Correcting for WorldCom's Overstated Collocation Costs Makes the Case for No Impairment Even Stronger



- WorldCom used collocation costs that are totally out of line with current rates
- Replacing WorldCom's overstated collocation costs with current actual collocation rates provides a more accurate picture of the margin available to facility based CLECs
- No changes made to WorldCom's calculation of SDO, transport and NRC costs

Key Point: Correcting for WorldCom's overstated collocation costs makes it even more apparent that CLECs can profitably serve wire centers with greater than 5000 lines

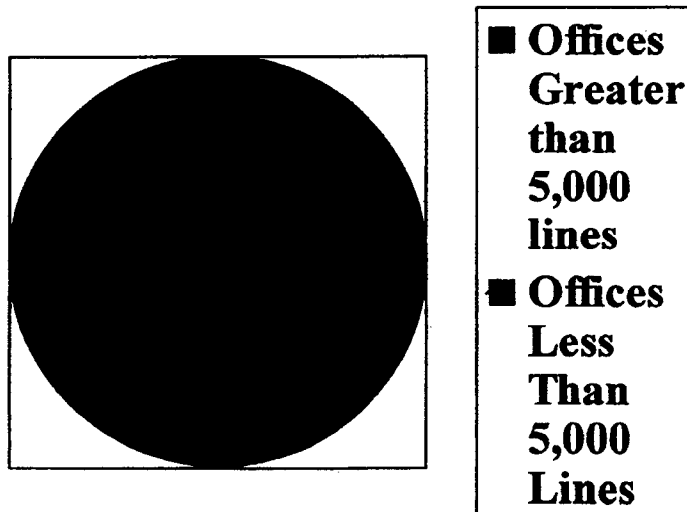
View with Corrected Collocation Costs and Retail Residential Complete Choice Service



- Average Retail Revenue consists of Residence Complete Choice Service (\$31.64), SLC (\$6) and SWA (\$3.92)
- WorldCom and AT&T are currently targeting high revenue residential customers as evidenced by their pricing plans

Key Point: CLECs can profitably serve residential customers in wire centers with greater than 5000 lines

Most Wire Centers Located Outside of an MSA Have Less Than 5,000 Lines



Outside of an MSA Breakdown

- Within BellSouth's serving area, 65% of the wire centers located outside of an MSA have less than 5,000 lines. Within MSAs, 27% of wire centers have less than 5,000 lines.
- 44% of BellSouth's total wire centers have less than 5,000 total lines
- An initial trigger based on 5,000 total lines in the wire center would thus ensure that many "rural" areas continue to have UNE-P available.

Overview of Analysis Using WorldCom Cost Study

- WorldCom provided a cost study in its ex parte of January 8, 2003. BellSouth used the costs provided by WorldCom to determine whether a CLEC could profitably serve an area given those costs. BellSouth used WorldCom's costs for "Switching, Digitization and OSS" (SDO), Transport and Nonrecurring. BellSouth also used WorldCom's cost for collocation in Scenario 1.
- BellSouth used WorldCom's costs from its Case 2 analysis, with a 5% market-share. This was a conservative view, as use of higher market-share assumptions (WorldCom also modeled 7% and 10%) would lower the CLEC's cost per line.
- To the above costs, BellSouth added the cost of an average UNE loop. This cost is based on a weighted average from BellSouth's 9 state operating region. BellSouth then calculated an average revenue per line based on average business revenues per line and average revenue for BellSouth's Complete Choice residential customers (Complete Choice provides customers a combination of basic service and switch based vertical services). This number was rounded to \$50.00 for use in Scenario 1. SBC provides additional documentation to support a \$50.00 revenue figure in its 1/14/03 ex parte. The difference between cost and retail revenue per line provides the gross margin per line. BellSouth also added in Selling, General and Administrative costs (SG&A), taken from the FCC's Synthesis Model, to arrive at a net margin per line.
- BellSouth then corrected WorldCom's collocation costs to reflect current collocation rates (See Scenario 2). WorldCom apparently used overstated collocation costs in its original analysis. To correct the collocation costs, BellSouth used actual rates from its Georgia SGAT. Those calculations are shown in detail on the following pages. It should be noted that BellSouth made the conservative assumption that WorldCom would use caged collocation. If rates for cageless collocation were used, the collocation rates would be even lower.
- BellSouth then compared these costs to BellSouth's Average Residence Complete Choice revenue, (Scenario 3).

BellSouth's Analysis showing that CLECs can profitably serve customers in wire centers with > 5,000 lines

Scenarios 1 and 2

5% Market Share - WorldCom's Case 2: UNE - Avg Retail Local Revenue																	
Scenario 1	SDO *	Trans	NRC	Total SDO, Trans & NRC	Collo	UNE Loop	Total CLEC Cost	Avg Retail Local Rev **	Gross Margin	% Gross Margin	SG&A	Net Margin	% Net Margin	COs	Lines	Lines per CO	5% share
Lines >25k	\$4.76	\$0.85	\$2.50	\$8.11	\$2.89	\$16.61	\$27.61	\$50.00	\$22.39	45%	\$7.32	\$15.07	30%	619	23,647,711	38,203	1,910
25K>Lines>15K	\$5.14	\$0.99	\$2.50	\$8.63	\$5.16	\$16.61	\$30.40	\$50.00	\$19.60	39%	\$7.32	\$12.28	25%	490	9,604,473	19,601	980
15K>Lines>5K	\$6.02	\$1.36	\$2.50	\$9.88	\$10.59	\$16.61	\$37.08	\$50.00	\$12.92	26%	\$7.32	\$5.60	11%	1,079	9,756,196	9,042	452
Lines <5K	\$10.09	\$2.86	\$2.50	\$15.45	\$46.50	\$16.61	\$78.56	\$50.00	-\$28.56	-57%	\$7.32	-\$35.88	-72%	2,155	4,240,193	1,968	98
* Switching, digitization and OSS																	
** Approximation of BellSouth's average retail local revenue. Does not include revenues from long distance, memory call or inside wire. Supported by SBC's 1/14/03 ex parte.																	
5% Market Share - WorldCom's Case 2: UNE w/corrected collocation costs - Avg Retail Local Revenue																	
Scenario 2	SDO *	Trans	NRC	Total SDO, Trans & NRC	Correct- ed Collo	UNE Loop	Total CLEC Cost	Avg Retail Local Rev **	Gross Margin	% Gross Margin	SG&A	Net Margin	% Net Margin	COs	Lines	Lines per CO	5% share
Lines >25k	\$4.76	\$0.85	\$2.50	\$8.11	\$1.97	\$16.61	\$26.69	\$50.00	\$23.31	47%	\$7.32	\$15.99	32%	619	23,647,711	38,203	1,910
25K>Lines>15K	\$5.14	\$0.99	\$2.50	\$8.63	\$2.89	\$16.61	\$28.13	\$50.00	\$21.87	44%	\$7.32	\$14.55	29%	490	9,604,473	19,601	980
15K>Lines>5K	\$6.02	\$1.36	\$2.50	\$9.88	\$5.11	\$16.61	\$31.60	\$50.00	\$18.40	37%	\$7.32	\$11.08	22%	1,079	9,756,196	9,042	452
Lines <5K	\$10.09	\$2.86	\$2.50	\$15.45	\$19.87	\$16.61	\$51.93	\$50.00	-\$1.93	-4%	\$7.32	-\$9.25	-19%	2,155	4,240,193	1,968	98
* Switching, digitization and OSS																	
** Approximation of BellSouth's average retail local revenue. Does not include revenues from long distance, memory call or inside wire. Supported by SBC's 1/14/03 ex parte.																	
*** Corrected collocation costs based on GA SGAT rates																	

Scenarios 3 and 4

1.

Calculation of Collocation Costs Based on Actual Rates

Collocation	Georgia - BGAT				
	NRC	Recurring			
Space Availability Report	\$2,148.00	\$0.00			
Application Fee per Collo (Initial)	\$3,850.00	\$0.00			
Space preparation - firm order processing	\$1,187.00	\$0.00			
Space preparation - CO mod per sq ft	\$0.00	\$2.02			
Space preparation - Common Sys mod per cage	\$0.00	\$95.23			
Cable records, per request	\$1,706.00	\$0.00			
Cable installation, per cable	\$2,750.00	\$0.00			
Cable support structure, per entrance cable	\$0.00	\$13.35			
Floor Space per sq ft	\$0.00	\$7.50			
Power, per Fused Amp	\$0.00	\$8.08			
Welded Wire Cage - First 100 sq ft	\$0.00	\$161.27			
Welded Wire Cage - Each additional 50 sq ft	\$0.00	\$15.82			
Security System per sq ft	\$0.00	\$0.0172			
Security Access System per card	\$46.20	\$0.0607			
Collocation Build-out	\$16,281.80				
Monthly Recurring Charges		\$1,720.76			
Assumptions:					
Amps used		60			
Square Feet		100			
Security Cards		4			
Requests for Cable Records		2			
Cable Support Structures		2			
Nonrecurring Charge per 2-Wire Cross Connect	\$12.60				
Monthly Recurring Charge per 2-Wire Cross Connect		\$0.30			
Case 2: UNEs and 5% market share	Avg Lines in CO per MCI	5% share of avg lines in CO			
Lines > 25k	38,203	1,910			
25k > Lines > 15k	18,601	980			
15k > Lines > 5k	9,042	452			
Lines < 5k	1,968	98			
Case 2: UNEs and 5% market share	Collo NRC per line *	Collo Recurring per line	2-W cross connect NRC per line **	2-W cross connect Recurring per line	Collo Total per line
Lines > 25k	\$0.07	\$0.90	\$0.70	\$0.30	\$1.97
25k > Lines > 15k	\$0.14	\$1.76	\$0.70	\$0.30	\$2.89
15k > Lines > 5k	\$0.30	\$3.81	\$0.70	\$0.30	\$5.11
Lines < 5k	\$1.38	\$17.49	\$0.70	\$0.30	\$19.87
* Collocation Build-out costs amortized over 10 years and divided by 5% share of lines in CO					
** 2-W Cross Connect NRC amortized over 18 months customer life					

ATTACHMENT 2

SBC Impairment Analysis



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Senior Vice President

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January 14, 2003

Via Electronic Submission

Chairman Michael Powell
Federal Communications Commission
445 12th Street, SW, 8th Floor
Washington, D.C. 20554

**Re: Ex Parte Presentation
UNE Triennial Review Proceeding – CC Docket No. 01-338
Local Competition Proceeding – CC Docket No. 96-98
Deployment of Advanced Wireline Services – CC Docket No. 98-147**

Dear Chairman Powell:

On January 8, 2003, WorldCom acknowledges for the first time, and contrary to its prior claims, that a CLEC may be able to serve residential customers without the UNE-P in certain wire centers.¹ After setting forth a putative analysis of the economics of using a UNE loop strategy to serve residential customers in particular-sized wire centers, it concludes that "UNE-L might prove to be a feasible alternative to UNE-P in some central offices, particularly those with relatively large numbers [25,000 or more] of residential lines."

SBC welcomes WorldCom's acknowledgement that facilities-based residential competition may be feasible after all. We take sharp issue, however, with the methodology and certain of the assumptions underlying WorldCom's analysis.² In fact, insofar as WorldCom

¹ Letter from Gil M. Strobel, Lawler, Metzger & Milkman, LLC, to Marlene H. Dortch, Secretary, FCC, January 8, 2003.

² In addition to presenting a purported economic analysis of the viability of a UNE loop strategy, WorldCom raises two operational issues. *First*, it claims that incumbent LECs can perform only a few thousand hot cuts per month. SBC already has shown this claim to be untrue, and it is noteworthy that WorldCom does not even purport to refute SBC's showing. Suffice it to say that SBC *today* performs more than a few thousand hot cuts per month; in fact, from June 2001 through May 2002, SBC performed 500,00 hot cuts. Moreover, as detailed in its previous filings, SBC can substantially increase the number of hot cuts it performs with its existing work force with no degradation in service quality. See Attachment 5. *Second*, WorldCom claims that it takes fourteen months to obtain and prepare collocation space and that, even where it has existing collocation arrangements, it would take eight months to obtain additional space and install and test new equipment. These time estimates are grossly inflated. As an

bases its analysis on a comparison of UNE-P rates with the costs of a UNE loop strategy, its methodology has been squarely rejected by both the Supreme Court and the D.C. Circuit.³ It also is “empirically and theoretically incorrect.”⁴ By contrast, we attach to this letter a legally sustainable, analytically sound analysis of the viability of a UNE loop strategy using appropriate assumptions – some of which actually result in higher estimated CLEC costs than WorldCom’s assumptions.⁵ As shown in the summary set forth in Table A, this analysis reveals that CLECs can earn a positive margin providing facilities-based residential service in wire centers with 5000 or more lines. To the extent they also serve business customers, they could profitably serve even smaller wire centers. These conclusions, moreover, are further buttressed by marketplace evidence, which shows that CLECs *today* are using their own switches to serve customers in more than three quarters of SBC’s wire centers with 5000 or more lines and thus already have incurred many of the costs needed for facilities-based residential service in those wire centers.⁶

In its analysis, SBC compares the costs of a UNE loop strategy, not to the cost of the UNE-P, but to the revenue opportunity available to new entrants.⁷ To calculate CLECs’ costs, SBC developed a model that assumes the same principal network configuration that WorldCom uses in its cost estimate. Specifically, SBC assumes that a CLEC would connect unbundled loops to collocated GR 303 concentration equipment in each wire center and then use unbundled dedicated transport to haul its traffic to its own switch.⁸ Because CLECs, as a rule, offer and

initial matter, CLECs can and presumably would rely on virtual, not physical collocation to provision residential service, and virtual collocation intervals in SBC’s region range from 70 to 110 days. Even if CLECs also relied on physical collocation, the intervals are far lower than suggested by WorldCom, ranging from 90 to 126 days for previously conditioned space and from 90 to 180 calendar days for unconditioned space. Those deadlines can be extended only 20 business days where space is not readily available.

³ For a fuller explanation of why WorldCom’s analysis is inconsistent with legal precedent, see Attachment 1.

⁴ See Attachment 1, which explains, not only why WorldCom’s analysis is inconsistent with the law, but also shows that this analysis is analytically flawed and rests on numerous unreasonable assumptions. See also letter from Dr. Howard Shelanaky to William Maher, a copy of which is set forth as Attachment 2, which shows that WorldCom’s analysis is at odds with sound economic principles.

⁵ See Attachment 3.

⁶ SBC derived this evidence by looking at the percentage of its wire centers with 5000 or more lines in which one or more CLECs had ported a telephone number to their own switch. The Commission has recognized that ported numbers “provide insights into the number of customer lines served by competitors.” See, e.g., *FCC Local Competition Report*, August 1999 at 43.

⁷ Comparing costs with revenue opportunities for residential customers theoretically could implicate the D.C. Circuit’s warning that below-cost, subsidized retail rates are not a source of impairment. Because CLECs pursue only relatively high-end customers, a real-world analysis of the ability of CLECs to earn a margin avoids this concern.

⁸ For purposes of its analysis, which focuses exclusively on smaller wire centers in rural areas, SBC assumes that CLECs would use UNE transport. In larger wire centers, CLECs presumably would rely on

promote packages of local and long-distance services, SBC also included the costs of providing long-distance services. Although CLECs already have deployed more than 1300 switches and obtained thousands of collocation arrangements, SBC assumes, conservatively, that a CLEC would deploy a new switch (or switches) in every serving area and would require a new collocation arrangement in every wire center that we modeled.⁹

SBC also used extremely conservative assumptions in calculating the revenue opportunity available to CLECs. Specifically, we assumed that CLECs would serve only residential lines, notwithstanding that they already are serving substantial numbers of business customers with their own switches. Since the revenues available from business customers far exceed the revenues available from residential customers, the exclusion of business revenues from our analysis significantly understates the actual revenue opportunity available to CLECs and therefore overstates the line size required for CLECs profitably to serve a wire center.

To calculate the residential revenue opportunity on a per-line basis, we relied on the retail prices of the residential packages CLECs actually market and sell today. We thus assumed a revenue opportunity of \$40 to \$60 per line (an average of \$50), plus \$8 in switched access, EUCL, and universal service revenue. In a previous filing, a copy of which is provided as Attachment 4, SBC shows more fully why these revenue estimates are reasonable. For present purposes, we note that the average of \$50 per line that we use is the *lowest* price point of MCI's The Neighborhood offering, which also is priced as high as \$70. To calculate the revenue opportunity in the wire center as a whole, we used the same market share assumptions made by WorldCom – specifically, that a CLEC would capture five to ten percent market share in the wire center in question. Given the rapid pace at which CLECs have gained market share in states in which they have actively marketed residential service, and the even greater success they have had in winning business customers, these assumptions, particularly the low-end assumption, are quite conservative.

Based on the cost and revenue assumptions described above, we determined that a CLEC could earn a positive margin in a wire center with 5000 or more lines, assuming, consistent with WorldCom's analysis, that it could obtain a five to ten percent market share in that wire center. Because a five to ten percent market share in a 5000 line wire center represents 250 to 500 lines, we show in *Attachment 3* the per line costs and associated margins for a CLEC with 250 and 500 lines in wire centers in three representative SBC states: California, Michigan, and Texas.

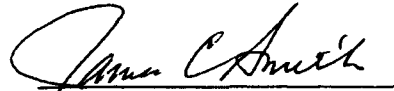
While SBC's analysis shows that CLECs can earn margins when they use their own switches to serve residential customers in wire centers with 5000 or more lines, the fact that CLECs may or may not be able to earn margins in smaller wire centers does not warrant a finding of impairment in those wire centers. The critical issue is not whether CLECs can serve

special access services or their own facilities because they would not be impaired without access to unbundled dedicated transport.

⁹ To the extent CLECs can use their existing switches and collocation arrangements, their costs would be lower than assumed in SBC's model.

every wire center profitably, but whether they can viably serve a particular *market*. Because wire centers with fewer than 5000 lines account for a minority of all subscriber lines, notwithstanding that they represent almost half (42.3%) of SBC's wire centers, it is reasonable to assume that any losses a CLEC incurs in those wire centers will be more than offset by profits earned in larger wire centers in those same markets. Stated differently, just as incumbent LECs must offset losses incurred in certain wire centers with profits from others, the same should be expected of CLECs. Thus it would be reasonable for the Commission to conclude that CLECs are not impaired anywhere without access to unbundled switching.

Respectfully Submitted,



James C. Smith
Senior Vice President

Attachments

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Table A

CLEC Margin Analysis

California		CLEC Retail Price Points ¹		
		\$40	\$50	\$60
		Margin ²		
Market Share	5%	-\$2.31	\$5.69	\$13.69
	10%	-\$0.65	\$8.65	\$16.65

41.35

Michigan		CLEC Retail Price Points ¹		
		\$40	\$50	\$60
		Margin ²		
Market Share	5%	-\$0.97	\$8.97	\$16.97
	10%	\$6.48	\$14.48	\$22.48

35.2

Texas		CLEC Retail Price Points ¹		
		\$40	\$50	\$60
		Margin ²		
Market Share	5%	-\$3.25	\$4.75	\$12.75
	10%	-\$0.03	\$7.97	\$15.97

42.03

39.63

¹ Price points for bundled package of local, intraLATA toll and long distance service.

² Margins account for both operational costs and SG&A (SG&A is estimated as 20% of revenue).

Attachment 3

**SBC'S ANALYSIS OF THE ECONOMIC VIABILITY OF
FACILITIES-BASED UNE-L RESIDENTIAL SERVING ARRANGEMENTS**

SBC developed a model to determine the economic viability of serving residential customers using a local serving arrangement consisting of CLEC switching and UNE loops ("UNE-L"). Specifically, SBC compares the cost of a UNE-L-based serving arrangement with the revenue stream a CLEC could reasonably anticipate when serving residential customers.

To calculate CLECs' costs, SBC developed a model that assumes the same principal network configuration that WorldCom uses in its cost estimate. Specifically, SBC's model calculates the recurring and non-recurring cost of obtaining and using unbundled loops, collocation, GR-303 DLC concentration equipment, switching, and transport.¹ Although CLECs already have deployed more than 1300 switches and obtained thousands of collocation arrangements, SBC assumes, conservatively, that a CLEC would deploy a new switch (or switches) in every serving area and would require a new collocation arrangement in every wire center that SBC modeled. Because CLECs, as a rule, offer and promote packages of local and long-distance services, SBC also included the costs of providing long-distance services.

SBC evaluated profitability under various assumptions regarding the number of lines a CLEC could expect to serve in each wire center. The analysis shows that using conservative assumptions, a CLEC could earn a positive margin in a wire center with 5000 lines. The model assumes, consistent with WorldCom's analysis CLEC market shares of five to ten percent. Because a five to ten percent market share in a 5000 line wire center represents 250 to 500 lines, SBC calculated the per line costs and associated margins for a CLEC with 250 and 500 lines in wire centers in three representative SBC states with the highest UNE-P volumes: California, Michigan, and Texas.²

In its analysis, SBC compares the costs of a UNE loop strategy, not to the cost of the UNE-P, but to the revenues a CLEC could reasonably expect in each wire center. In calculating this revenue opportunity, SBC used extremely conservative assumptions. Most notably, SBC used only *residential* revenue, notwithstanding that CLECs already are serving large numbers of business customers with their own switches. Since the revenues available from business customers far exceed the revenues available from residential customers, the exclusion of business revenues from SBC's analysis significantly understates the actual revenue opportunity available to CLECs and therefore overstates the line size required for CLECs profitably to serve a wire center.

¹ For purposes of its analysis, which focuses exclusively on smaller wire centers, SBC assumes that CLECs would use UNE transport. In larger wire centers, CLECs presumably would rely on special access services or their own facilities because they would not be impaired without access to unbundled dedicated transport.

² Although SBC does not include the per line cost at line counts higher than 500, such costs are even lower.

SBC based its revenue calculations on the retail prices of the residential services CLECs market and sell today. SBC thus assumed a revenue opportunity of \$40 to \$60 per line (plus \$8 in switched access, EUCL, and universal service revenue). In a previous filing, a copy of which is provided as Attachment 4, SBC shows more fully why these revenue estimates are reasonable. As an example, however, the average of \$50 per line that SBC used is the *lowest* price point of MCI's The Neighborhood offering, which also is priced as high as \$70.

To calculate the revenue stream available to CLECs in a wire center as a whole, as noted above, SBC used the same market share assumptions made by WorldCom. Specifically, SBC assumed that, on average, a CLEC would capture five to ten percent market share per wire center. Given the rapid pace at which CLECs have gained market share in states in which they have actively marketed residential service, and the even greater success they have had in winning business customers, these assumptions, particularly the low-end assumption, are quite conservative. Based on these 5% and 10% market share assumptions, SBC's calculations show that CLECs can earn positive margins when they use their own switches in wire centers with 5000 or more lines and offer the same service packages they are offering today.

I. Cost

The SBC model calculates the per line cost of each of the following components of a UNE-L-based local serving arrangement:

A. *UNE Loop*

SBC's model calculates the monthly recurring and amortized monthly non-recurring cost of the two-wire analog loops and cross-connects that a facilities-based CLEC would purchase to serve mass-market customers. In order to calculate UNE loop costs, SBC's model uses the actual UNE loop rates established by the California, Michigan, and Texas Commissions.

SBC determined that 56% of its wire centers with 10,000 lines or less are in the Zone 3 (highest) deaveraged UNE loop pricing zone, and 44% are in either the Zone 1 (lowest) or Zone 2 (middle) deaveraged UNE loop pricing zones. SBC's model thus uses a blended recurring UNE loop rate, reflecting 56% of the Zone 3 loop rate and 44% of the Zone 2 loop rate in each state.³ In Michigan and Texas, the model also adds the recurring monthly charges for loop-to-collocation cross connects. (There is no such charge in California).

California:

Zone 3 Recurring Loop Rate	Zone 2 Recurring Loop Rate	Blended Recurring UNE Loop Rate
\$19.64	\$11.27	$(.56*19.64)+(.44*11.27) = \15.96

³ SBC's loop cost calculation is thus conservative because it uses only the Zone 2 loop rate for the 44% component of the blended rate, even though some wire centers represented by the 44% are in Zone 1.

Michigan:

Zone 3 Recurring Loop Rate	Zone 2 Recurring Loop Rate	Cross Connect	Blended Recurring UNE Loop Rate
\$12.54	\$8.73	\$0.13	$(.56*12.54)+(.44*8.73) + 0.13 = \10.99

Texas:

Zone 3 Recurring Loop Rate	Zone 2 Recurring Loop Rate	Cross Connect	Blended Recurring UNE Loop Rate
\$18.98	\$13.65	\$1.24	$(.56*18.98)+(.44*13.65) + \$1.24 = \$17.87$

For non-recurring loop costs, the SBC model reflects current CLEC ordering activity for both coordinated hot-cut ("CHC") and frame due time ("FDT") loop cutovers. The model thus calculates non-recurring loop costs based on the percentage of CHC and FDT ordering activity in each state. For California, the model reflects that 32% of a CLEC's total hot cut orders will be CHCs and 68% will be FDTs. In Texas, it reflects that 43% of a CLEC's total hot cut orders will be CHCs and 57% will be FDTs.⁴ Currently, there are no separate charges for CHCs in Michigan (or any of the Ameritech states). However, to be conservative, the model assumes that there may be such charges in the future. SBC therefore used the Texas percentages of CHCs and FDTs, as well as the Texas CHC and FDT rates, for calculating Michigan hot cut costs.

The model also includes all additional UNE loop non-recurring charges, including service order charges, that may be assessed for each UNE loop service order submitted by a CLEC. In addition, although WorldCom failed to provide any support for its estimated \$10 internal CLEC cost associated with hot cuts, SBC's model conservatively includes an additional \$10 to reflect such costs. Finally, similar to WorldCom's estimate, SBC's model assumes that UNE loop non-recurring costs are amortized over 18 months.⁵ The following are the per line, monthly amortized non-recurring costs used in SBC's model:

California	\$3.77
Michigan	\$3.16
Texas	\$2.82

⁴ By reflecting current CHC and FDT ordering activity, the model is overly conservative in its assumptions. For mass-market customers, CLECs likely will rely on FDT cutovers, and the overall ratio of FDT to CHC cutovers would thus be much greater.

⁵ For all monthly amortizations, SBC used a 12.19% interest rate.

The total monthly per line loop costs calculated by the model are thus:

California	$(15.96 + 3.77) = \$19.73$
Michigan	$(10.99 + 3.16) = \$14.15$
Texas	$(17.87 + 2.82) = \$20.69$

B. Collocation

The SBC model assumes that a facilities-based CLEC will purchase virtual collocation. CLECs can collocate GR-303 equipment in virtual collocation, and physical collocation offers no advantage over virtual collocation for serving mass-market customers using GR-303 equipment. Virtual collocation also tends to cost less than physical collocation, especially for the equipment and configurations that likely would be used by CLECs to serve mass-market customers, and virtual collocation generally has shorter provisioning intervals than physical collocation.

Using SBC's tariffed virtual collocation rates, the model calculates the cost of the virtual collocation arrangements that a facilities-based CLEC would actually use for the GR-303 concentration equipment necessary to serve mass-market customers. The SBC model, moreover, is overly conservative in that it assumes a CLEC will have to purchase virtual collocation in each SBC wire center, and it does not discount the cost of collocation to account for the fact that many CLECs already are collocated in many of SBC's wire centers and in ILEC wire centers throughout the country.⁶

The following are the virtual collocation costs by line count used in SBC's model:

California:

Lines	Non-recurring Cost	Monthly Recurring Cost
250	\$4,775	\$539.16
500	\$4,775	\$539.16

Michigan:

Lines	Non-recurring Cost	Monthly Recurring Cost
250	\$8,743.21	\$1,152.06
500	\$10,475.11	\$1,164.78

⁶ The *UNE Fact Report* calculates that by year-end 2001, CLECs had purchased almost 25,000 collocation arrangements throughout the country, and that BOC end offices serving more than 80% of all BOC access lines have one or more collocators. *UNE Fact Report* at II-16.

Texas:

Lines	Non-recurring Cost	Monthly Recurring Cost
250	\$9,937.54	\$542.97
500	\$12,349.10	\$555.85

Consistent with WorldCom's collocation costs estimates, collocation were amortized over 10 years. The resulting amortized monthly collocation costs per line are:

California:

Lines	Amortized Monthly Cost Per Line
250	\$2.43
500	\$1.22

Michigan:

Lines	Amortized Monthly Cost Per Line
250	\$5.11
500	\$2.63

Texas:

Lines	Amortized Monthly Cost Per Line
250	\$2.75
500	\$1.47

C. CLEC GR-303

SBC's model includes the Engineered, Furnished & Installed ("EF&I") cost of the hardware, software, and cabling and wiring associated with GR-303 DLC concentration equipment in a configuration representing a 4:1 concentration ratio. Specifically, the model reflects actual prices of GR-303 equipment produced by a major manufacturer and the installation costs for that equipment in virtual collocation space in a configuration similar to that used by SBC's CLEC affiliate. A CLEC entering the mass-market on a significant scale could obtain similar prices and installation costs. SBC amortized GR-303 costs over 9 years to obtain a monthly per line cost.

Lines	Per Line GR-303 Cost	Amortized Monthly Per Line GR-303 Cost
250	\$84.98	\$1.30
500	\$50.38	\$0.77

D. CLEC Switch

SBC's cost calculation for switching is based on a switch equipped to serve 16,128 customers with a 4:1 concentration ratio for both GR-303 and trunking.⁷ SBC also assumed an 85% switching fill factor consistent with WorldCom's analysis. As with collocation, SBC's switch costs are conservative because the model does not discount switch costs to reflect the fact that CLECs already have deployed a substantial number of switches.⁸

The calculated per line monthly switch cost includes initial switch investment as well as EF&I costs and annual charge factors for building, land, power, maintenance, and other switch-associated deployment costs. The calculations are based on a switch cost estimator used by SBC's CLEC subsidiary. The switching cost data are based on SBC Telecom's contract with a major switch vendor and thus represent real-world costs that a facilities-based CLEC would incur in purchasing switches.

The cost of the switch modeled is \$2,061,188, to which SBC added the cost of multiplexing equipment in the amount of \$99,297 to account for the DS1 level signal for transport. The total cost of the switch in SBC's model is thus \$2,160,485. This includes installation, transportation, cabling and wiring, and miscellaneous equipment, and is representative of the real installation costs a CLEC would incur for this switch configuration. On a per line basis, with 85% fill, the cost is \$158.00. Adding in all associated switch deployment costs, SBC's model calculates the total cost of switching to be \$216.60 per line in California, \$198.32 per line in Michigan, and \$205.22 per line in Texas. SBC also calculated switch maintenance and other operating costs of \$1.19 per line per month in California, \$0.99 per line per month in Michigan, and \$1.08 per line per month in Texas. Amortizing over 10 years, SBC calculated the total monthly switch cost to be \$4.32 per line per month in California, \$3.68 per line per month in Michigan, \$4.05 per line per month in Texas.

E. Transport

For purposes of this analysis, which focuses on relatively small, predominately rural and suburban wire centers, SBC calculated the cost of transport based on unbundled dedicated transport prices. As with collocation and switching, the model is conservative in that it does not discount the cost of transport to reflect the fact that CLECs may have their own transport networks and thus would not need to purchase additional transport from SBC. SBC used the unbundled dedicated transport rates established by the California, Michigan and Texas Commissions. SBC assumed 25 air miles of transport.

⁷ The switch reflected in the cost model has the capacity to grow to serve over 100,000 customers. Adding additional lines would reduce the cost per line for switching. Thus, a switch equipped to serve 32,256 lines would cost \$3,115,036, or \$96.57 per line. At 64,512 lines, the cost would drop to \$77.88 per line.

⁸ The *UNE Fact Report* demonstrates that CLECs already have deployed more than 1,300 circuit switches throughout the country and are currently using those switches to serve customers in BOC wire centers accounting for nearly 86% of all BOC access lines. *UNE Fact Report* at II-1, II-6.

For non-recurring transport costs, the model assumes that only one LSR is required for all DS1s needed to provision each line count. The non-recurring transport costs are amortized over 18 months.

The monthly transport costs used in the model are:

California:

Lines	Amortized Monthly Cost Per Line
250	\$5.49
500	\$5.49

Michigan:

Lines	Amortized Monthly Cost Per Line
250	\$2.89
500	\$2.87

Texas:

Lines	Amortized Monthly Cost Per Line
250	\$5.11
500	\$4.98

F. Miscellaneous Costs

In order to provide a complete picture of CLEC costs, SBC included SG&A costs of 20% of revenue. Consistent with its December 11, 2002, *ex parte* presentation, and to properly compare costs with the revenue opportunities available to CLECs selling bundles of local and long distance services, SBC also included long distance costs of \$5.00.

G. Total Cost

Adding together all of the above cost components, SBC calculated the total per line costs of providing a package of local and long-distance services using a UNE-L serving arrangement to be:

California:

Lines	Amortized Monthly Cost Per Line (@\$40)	Amortized Monthly Cost Per Line (@\$60)
250	\$50.31	\$54.31
500	\$47.35	\$51.35

Michigan:

Lines	Amortized Monthly Cost Per Line (@40)	Amortized Monthly Cost Per Line (@\$60)
250	\$47.03	\$51.03
500	\$41.52	\$45.52

Texas:

Lines	Amortized Monthly Cost Per Line (@40)	Amortized Monthly Cost Per Line (@\$60)
250	\$51.25	\$55.25
500	\$48.03	\$52.03

II. Revenue Opportunities

Consistent with its November 18, 2002, *ex parte* presentation, SBC used a low total revenue estimate of \$48.00 and a high total revenue estimate of \$68.00. As SBC thoroughly documented in its December 11, 2002, letter to the Commission, these estimates are fully consistent with the local and long distance service package sold by CLECs to residential customers. SBC thus assumes that CLECs would continue offering the same services at the same prices they sell today using the UNE-P. Notably, WorldCom has recently raised the maximum price of the Neighborhood from \$59 to \$69. SBC's analysis does not take this increase into account, but if CLECs increased the prices of their packages, their margins obviously would grow concomitantly larger. As noted, the conservative nature of SBC's revenue estimates is further underscored by the fact that SBC assumed that CLECs would serve only residential customers, notwithstanding that business revenues tend to be much higher.

III. Margin Analysis

In order to determine the economic viability of UNE-L based service arrangements, SBC compared the cost of such arrangements with the revenue opportunities available to CLECs. At 250 and 500 lines, SBC compared the total cost per line of using a UNE-L serving arrangement with the low and high revenue estimates. SBC then calculated the margin for each line count for both the low and high revenue estimate.

The results demonstrate that CLECs can earn positive margins when they use their own switches and UNE-L-based serving arrangements for residential service in wire centers of 5,000 or more lines. *See Table A, supra.*

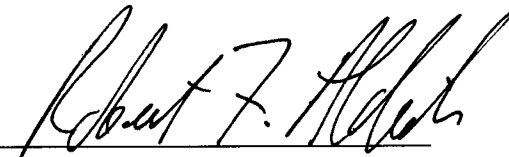
CERTIFICATE OF SERVICE

I hereby certify that, on October 19, 2004, a copy of the foregoing reply comments of the Payphone Commenters, was served by electronic mail on the parties listed below:

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